1987 ANNUAL REPORT

INTERCO

Contents

INTERCO 75th ANNIVERSARY

This past year marks INTERCO's seventy-fifth year of operation since its formation in December, 1911. While originally established as a footwear manufacturing company, through an aggressive acquisition program, it has diversified into a number of other markets.

■ **INTERCO Today** is a broadly based major manufacturer and retailer of consumer products and services represented by four operating groups.

■ **Apparel Manufacturing Group** consists of 11 apparel companies operating 45 manufacturing plants and 12 major distribution centers. The group designs, manufactures and distributes a full range of branded and private-label sportswear, casual apparel, outer garments and headwear for men and women. Distribution is national in scope to department stores, specialty shops and other retail units. Substantial distribution, under private and branded labels, is also made to large national retail and discount chains.

■ **General Retail Merchandising Group** operates 201 retail locations in 15 states. General retailing includes large do-it-yourself home-improvement centers, discount stores, men's specialty apparel shops, and specialty department stores. Six regional distribution centers support these retail locations.

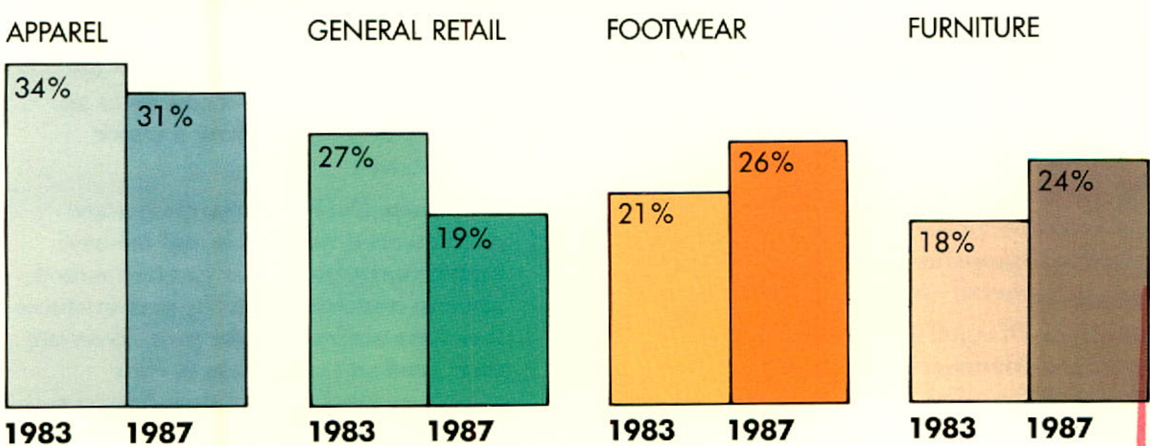
■ **Footwear Manufacturing and Retailing Group** styles, manufactures and distributes primarily men's footwear, and a broad range of athletic footwear, principally in the United States, Australia, Canada and Mexico. There are 14 manufacturing plants and five major distribution centers in operation. The group operates 820 retail shoe stores and leased shoe departments in 43 states in this country, as well as in Australia, Canada and Mexico. Footwear products are also distributed in more than 85 foreign countries.

■ **Furniture and Home Furnishings Group** manufactures and distributes quality furniture and home furnishings. There are 48 factories and 12 major distribution centers and consolidation warehouses located throughout the United States. The company also owns and operates 17 galleries.

HIGHLIGHTS

Years Ended	February 28, 1987	February 28, 1986	Change
From operations:			
Net sales	**$2,613,739,000**	$2,510,740,000	4.1 %
Net earnings	**98,643,000**	92,347,000	6.8 %
As a percent of sales	**3.8%**	3.7%	
Per share of common stock:			
Net earnings	**$3.13**	$2.92	7.2 %
Dividends	**$1.57**	$1.54	1.9 %
Financial condition:			
Working capital	**$ 789,892,000**	$ 847,182,000	(6.8)%
Current ratio	**3.4 to 1**	4.7 to 1	
Total assets	**1,720,712,000**	1,563,840,000	10.0 %
Shareholders' equity	**1,148,948,000**	1,111,293,000	3.4 %
Book value per common share	**$38.06**	$36.52	4.2 %
Shares outstanding at year end:			
Common	**28,565,253**	28,620,456	
Preferred	**617,946**	660,273	
Number of shareholders	**10,100**	10,500	
Number of employees	**47,000**	46,000	

Percent of Sales by Operating Group



TO OUR SHAREHOLDERS

Despite a generally soft economy, the management of your company is pleased to report that fiscal 1987 was a year of sales and earnings growth. Three of our four operating groups achieved gains, and major strides were made in broadening our business through strategic acquisitions.

Net sales for the year were \$2.61 billion, compared to \$2.51 billion in fiscal 1986. Net earnings were \$98.6 million compared to \$92.3 million a year ago. Earnings per share were \$3.13, compared to \$2.92 last year. Your company's after-tax profit margin grew to 3.8 percent of sales, and return on shareholders' equity increased to 8.8 percent.

We are encouraged by INTERCO's performance in the past fiscal year. However, much remains to be done, and we will not be complacent toward further improvement. The progress achieved during the year indicates both the essential strength of our operating companies and the viability of our long-range planning. These factors can be fully demonstrated, however, only through consistent progress toward our goals of:

- Increased return on corporate assets;
- Long-term sales and earnings growth; and
- Improved return on shareholders' investment.

Asset Redeployment

Beginning in 1984, INTERCO's management undertook an asset redeployment program intended to improve overall performance by concentrating on areas offering higher growth opportunities and improved profitability. During the past year, we completed the divestiture phase of this effort. We will continue to monitor the performance of all of our operating companies within the context of our overall corporate goals.

Of equal importance, during the year we commenced our most aggressive acquisition program since the beginning of the decade. Our acquisitions this year included:

- Purchase of Converse Inc., in September 1986, in a cash transaction. Converse complements our existing companies in the footwear market, enabling us to participate fully in the industry's fastest growing product category, athletic and leisure footwear. Converse is an outstanding brand name with broad consumer acceptance and an excellent position in the marketplace. Moreover, technology used to develop Converse's comfort and performance oriented footwear is the foundation for future quality products.
- Acquisition of Highland House, Inc., during October 1986, in a cash transaction. Highland House enjoys an excellent reputation in the upper middle price range of the upholstered furniture market. Its growth prospects are excellent and its product line supplements those of Ethan Allen and Broyhill.
- Subsequent to the close of our fiscal year, in April 1987, we merged with The Lane Company, Incorporated, a major furniture manufacturer. This transaction involved the exchange of 1½ shares of INTERCO common stock for each outstanding share of Lane common stock.

Lane is a leader in the furniture industry with broad consumer recognition and acceptance. Among Lane's many strengths, the Action Division competes in the important recliner market, a segment in which our existing furniture companies do not fully participate. With its excellent product line and strong reputation for quality, Lane provides additional growth opportunities in an industry in which we have a major commitment.

These new INTERCO companies are characterized by capable and talented management teams that can be counted upon to continue the strong performances they have achieved in the past. Moreover, their products are leaders in their respective markets, and their financial

outlook is consistent with our corporate growth objectives.

Operating Group Performance

Historically, INTERCO has achieved approximately 50 percent of its growth through acquisitions. We depend upon the entrepreneurial spirit and management skill of our existing operating companies to provide the remaining half of our increased performance. The past year has been no exception and results were generally positive.

- Apparel Manufacturing Group — Sales were $817.7 million, compared with $907.8 million one year ago and operating earnings were $47.3 million, compared to $66.7 million.
- General Retail Merchandising Group — Sales were $498.3 million, compared with $461.8 million last year and operating earnings were $40.6 million compared to $32.1 million.
- Footwear Manufacturing and Retailing Group — Sales were $663.5 million, compared with $558.3 million in the prior year and operating earnings were $52.1 million compared to $48.5 million.
- Furniture and Home Furnishings Group — Sales were $634.2 million compared with $582.8 million the previous year and operating earnings were $75.9 million, compared to $57.3 million.

Conditions in the apparel industry continued to be seriously affected by a variety of factors throughout fiscal 1987, including direct sourcing by many retailers, fewer advance seasonal orders by major chains, and deflationary price trends. These conditions had greater impact on the women's segment. Nonetheless, the Apparel Manufacturing Group is beginning to show signs of stabilization in the first part of the new year.

We have looked to the expertise of each of our apparel companies to address the difficult market conditions we have experienced. A number of new product introductions were announced by our apparel companies during the year in a continuing effort to respond fully to consumer trends. Moreover, we combined the management skills of the INTERCO apparel companies through a task force to review and identify various responses to changes in the apparel industry from a strategic vantage point. This group is exploring a wide range of options, including increased fashion orientation and alternative sourcing possibilities to better meet the needs of the marketplace. In this regard, Campus entered into a joint venture agreement with an established vertically integrated knit shirt manufacturer in Costa Rica, strengthening our competitive position within the United States market.

The General Retail Merchandising Group achieved an 8.1 percent return on sales, a record performance for this operating group. The group's volume and profitability growth was led by the do-it-yourself home improvement segment. Although the margins in this industry were severely affected several years ago by many new entrants and the resulting intense promotional competition, these pressures have abated somewhat and we anticipate continued strong performance from this sector.

Late in the year, Central Hardware acquired four new stores. Two of these facilities served to expand our operations in Cincinnati, Ohio, while the other two open a significant new market opportunity in Nashville, Tennessee.

The overall improvement in sales and earnings for the General Retail Merchandising Group reflected aggressive merchandising programs and cost control efforts undertaken by all of our companies.

Weak consumer demand last year carried over into the first half of fiscal 1987 for our Footwear Manufacturing and Retailing Group. However, trends strengthened during the second six months. In part, this positive shift

reflected improved conditions throughout much of the footwear industry. Our performance was also enhanced by the strong acceptance of new product introductions by Florsheim.

Following a successful pilot study, Florsheim expanded its electronic retailing program, providing video marketing units in 50 Illinois sites during the year. This innovative marketing approach can be used to supplement the performance of high traffic stores, or to make our products available in locations that would not normally support a full retail operation. Further expansion of the electronic retailing program will occur in the western part of the country early in the new year with an additional 60 to 65 units.

International Shoe continued its efforts to broaden its product offerings in the safety shoe and special applications markets. Senack achieved both increased sales and earnings despite intense promotional activity. Converse has experienced accelerated sales and earnings performance since its acquisition by INTERCO.

The Furniture and Home Furnishings Group achieved a record performance. Sales increased by 8.8 percent with ongoing cost reduction efforts further enhancing the group's operating profits, which rose 32.5%.

Both Ethan Allen and Broyhill have aggressively responded to continued consolidation within the furniture industry, paying particular attention to the development of improved dealer programs:

- Ethan Allen pioneered the gallery concept and it remains the cornerstone of its marketing strategy. In fiscal 1987, this effort was supplemented by the Standards of Operation Program through which Ethan Allen dealers were provided with a more complete line of coordinates and enhanced levels of decorating service, enabling them to serve their customers more effectively. The response to this program was very positive.

- Broyhill's Showcase Gallery Program provides dealers with a proven merchandising technique to increase sales and profits, while improving display of the full line of Broyhill products. Acceptance of this program has been excellent, with 230 Showcase Galleries now in operation and continued expansion planned in the current year.

Given continued low interest rates, positive demographic trends and a favorable housing market, the outlook for the Furniture and Home Furnishings Group remains encouraging.

Financial Position

INTERCO's financial position and cash flow remain strong. At the end of fiscal 1987, our working capital ratio was 3.4 to 1. Inventory turnover rates and accounts receivable collection cycles were maintained at quite satisfactory levels.

We anticipate capital expenditures of approximately $60 million during the year ahead, including the newly acquired companies. Our planned expenditures will again emphasize programs to reduce costs and improve productivity. We expect that funds generated from current operations will be sufficient to meet these needs, as well as finance our working capital requirements. INTERCO's 13.9 percent debt-to-capitalization ratio will provide maximum flexibility during the coming year.

The company considers share repurchase programs strategically important. During the past year, we purchased the equivalent of 400,000 shares of INTERCO common stock on the open market as part of our program to acquire a total of two million shares, as authorized by the Board of Directors in December, 1985.

We enhanced our stock's liquidity and provided opportunities for its broader distribution with a two-for-one stock split in July, 1986. Additionally, this past September the Board of Directors approved an increase in the annual dividend on INTERCO common stock to

$1.60 a share, effective with the dividend payable October 15, 1986.

INTERCO's First 75 Years

The past year marked the 75th anniversary of the founding of your company. INTERCO has changed greatly since 1911, but the entrepreneurial spirit that has prompted our growth for three-quarters of a century remains the keystone of INTERCO's operating philosophy.

We permit our managers to exercise fully their skills and ingenuity within the context of overall corporate objectives, nurturing a long tradition of marketing innovation. We focus on consumer product industries with which we are familiar, and concentrate our efforts behind quality products that have achieved a leadership position within their markets.

At the corporate level, our objective is to achieve a solid return on our shareholders' investment through a four-pronged approach:

- First, we continually strive to improve the operating efficiencies of our existing companies;
- Second, we attempt to achieve a higher return from our business mix by deploying the assets of any operations that consistently fall short of corporate objectives;
- Third, through strategic acquisitions we endeavor to broaden our business to include products and services that offer superior rates of return while complementing our existing companies; and
- Fourth, we are committed to pursue a vigorous asset management program to generate a strong cash flow capable of financing further growth.

In these ways, we are confident that we will continue to build a strong company throughout the remainder of INTERCO's first century.

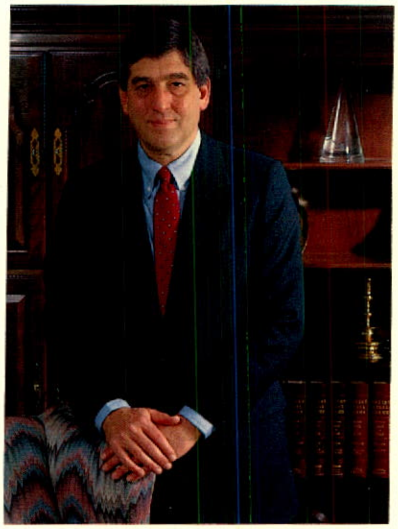
Changes on the Board of Directors

An active board of directors is vital to the performance of your company. We are indeed fortunate to benefit from the advice and counsel of a board comprised of outstanding individuals who are committed to INTERCO's long-term growth. It is with deep appreciation that we acknowledge the contribution made by Stanley M. Cohen who, during his 48-year career, directed the development and growth of Central Hardware Company. On March 1, 1987, Mr. Cohen retired from Central Hardware and as a vice president and a member of the Operating Board of INTERCO, and in June, 1987, will retire as a member of the INTERCO Board of Directors.

During the past year, we welcomed two new members to the board of directors. Robert H. Quenon, the president and chief executive officer of Peabody Holding Company, Inc., and Mark H. Lieberman, president of Londontown, a division of INTERCO. Concurrent with the Lane merger, R. Stuart Moore, President and Chief Executive Officer of Lane, was elected to the Board of Directors and a Vice President of INTERCO. We look forward to their service in the years to come.

As we enter a new year, we are hopeful that the progress made in fiscal 1987 will be carried forward. The strong performance of our General Retail and Furniture Groups, the positive trends in Footwear Manufacturing and Retailing, and the recent signs of stabilization within our Apparel Group, all give cause for optimism. Moreover, the acquisitions completed during the past year broaden and strengthen our overall business mix.

On behalf of INTERCO's management and directors, we greatly appreciate the continuing support of our customers, employees and shareholders during the past year, and will do our utmost to repay your confidence in us during fiscal 1988.



Harvey Saligman
Chairman of the Board and
Chief Executive Officer

April 14, 1987

CONVERSE JOINS INTERCO

Converse's athletic footwear has an excellent reputation for performance, supported by endorsements from outstanding professional players. Pictured above are Larry Bird and Magic Johnson, from the National Basketball Association, featuring the Converse *Weapons* basketball shoe.

Converse Inc., headquartered in North Reading, Massachusetts, joined INTERCO in September, 1986. A leader in the athletic footwear market, the Converse line of quality products have long enjoyed widespread consumer acceptance based on their technical superiority and performance characteristics.

Over the past four years, the athletic footwear industry has grown at an annual rate of approximately 12 percent. This growth has included the expanded use of athletic footwear for non-athletic purposes, particularly among teenagers and young adults. While maintaining their important position in the performance footwear sector, Converse has capitalized on this growth, while aggressively developing new product lines to meet evolving consumer needs. New product offerings in fiscal 1987 included:

- The *Conveyor* walking shoe, introduced following extensive research at the Converse biomechanics laboratory. Walking shoes are expected to offer high growth opportunities.
- A new line of performance-oriented dress and casual shoes under the *Hamptons* label. This collection features designs by Nino Cerruti, and special insole/outsole construction that provides consumers with a product that is substantially more comfortable than other dress and casual shoes. Following introduction in the fall of 1986 through major retail chains on both coasts, initial reaction to the *Hamptons* line has been excellent.
- In the canvas shoe segment, a variety of new *Chuck Taylor All Star* colors, a group of higher top *All Stars* called *Neehi*, a collection of low-cut models under the *Jams by Converse* label, and a selection of other low-cut models in various fashion and print colors.

■ A complete new line of performance tennis shoes for men and women bearing the *GSV* (for *Grand Slam Victory*) brand name, with endorsements by both Jimmy Connors and Chris Evert Lloyd.

■ The *Cons*, a major impact leather basketball shoe, in high, mid-cut and low styles. Positioned as both a performance shoe and as a street wear product, the *Cons* has achieved good initial acceptance.

■ A relatively new product segment — fitness shoes — with introduction of the *Aurora*, a fitness shoe for women, and the *AC Converter*, a similar product for men. This category was initially created in response to the need for women's aerobic shoes, and has now broadened to encompass all areas of fitness.

■ Several baseball, softball and football shoes which should result in good sales increases in the traditional cleated footwear market.

■ A broadened related line of casual apparel, under the *Chuck's* label, in an effort to increase its penetration of this growing market segment.

The entire Converse product line is supported by an aggressive advertising program that includes television, outdoor billboard, radio and printed media. These ads emphasize product quality, the active lifestyle of today's consumers, and the endorsement of well-known celebrities. Based on its strong track record, its widespread consumer acceptance, its technical superiority and its aggressive and proven management, it is anticipated that Converse will play an important role in INTERCO's future.

LANE JOINS INTERCO

On April 13, 1987, shareholder approval was given for the merger between INTERCO and The Lane Company, Incorporated, a major furniture manufacturer headquartered in Altavista, Virginia, with plants in four southeastern states. With the addition of Lane to INTERCO's Furniture and Home Furnishings Group, we are in a stronger position than ever to compete within this growing sector of our business.

Lane achieved an excellent sales and earnings record in the years preceding its merger with INTERCO. Based on a broad line of quality products, and a strong and experienced management team, total sales increased at an annual compounded growth rate of 12 percent during Lane's latest five years of operations. The *Lane* name, which is among the strongest furniture brand names has been nationally advertised for 65 years.

Lane's operating divisions include:

- *Action* reclining chairs.
- *HBF* business furniture.
- *Hickory Chair* traditional wood and upholstered furniture.
- *Hickory Tavern* upholstered furniture.
- *HTB* contemporary upholstered and occasional furniture.
- *Lane* cedar chests, bedroom, dining room and occasional furniture.
- *Pearson* upholstered furniture.
- *Royal Development* motion furniture mechanisms.
- *Venture* casual wood and upholstered furniture.

APPAREL MANUFACTURING GROUP

Londontown officially began in 1922, manufacturing fine clothing for discriminating gentlemen. Following World War II, they set out to combine these fine principles of tailoring with the rigid requirements of waterproof outerwear. The result was the introduction in 1954 of the *London Fog* weather coat which revolutionized the rainwear apparel industry. One of the original advertisements for this innovative product is shown above.

INTERCO's Apparel Manufacturing Group addressed challenging market conditions during fiscal 1987 with a broad array of products aimed at meeting the needs of today's fashion-conscious consumer.

■ Biltwell introduced a line of apparel for big and tall men based on an association with a popular entertainment figure, Ed McMahon, and bearing his name. In order to maintain the quality image appropriate for this product line, it will be sold exclusively through independent retailers who specialize in serving the tall or large customer.

■ Londontown has successfully introduced a new, prestigious line of rainwear under the *Tempo Europa* brand name. Utilizing a superior moisture resistant material and advanced styling, the product has achieved excellent acceptance during its first season. Based on this strong consumer response, the line is currently being expanded with additional styles and new offerings. Londontown continues to emphasize its highly popular *London Fog* collection with an extensive national advertising program to help sustain its leadership position.

■ Campus Sportswear sharpened the focus of its marketing efforts during the past year, with its two major labels for the department store and specialty store trade — *Le Tigré* for young men and boys, and *J. J. Cochran* for men. The mass merchant segment of the market is supported with an extensive line of young men's sportswear under the *Campus* label. The *Le Tigré* line has been broadened with the introduction of new colors and styles, including oversize shirts and "tough" rugby shirts, and innovative fabrication techniques, such as distressed fleece.

■ International Hat capitalized on recent fashion trends prompted by popular entertainment characters to identify new market niches. Generally, these new products are used to create an authentic look for fashion-conscious consumers.

■ Stuffed Shirt has responded to consumer demand for jeanswear with an expanded product line for skirts, jackets, shirts, dusters, shorts and casual pants. The installation of sophisticated computerized laundering equipment has enabled the company to remain price competitive while providing a variety of fabric finishes and textures for its products through refinements in the final wash process.

■ Devon Apparel has created new excitement in its *Blake* label by offering a more separates oriented line that emphasizes contemporary styling. This popular-priced collection of career-oriented sportswear focuses on woven fabrics.

■ Queen Casuals also appeals to the professional woman with its *Mallory & Crew* label, featuring updated, moderately priced related separates for career dressing and weekend wear. The *Smith & Jones* label continues to have strong appeal for the more traditional, career-minded woman who is attracted to their executive dressing concepts.

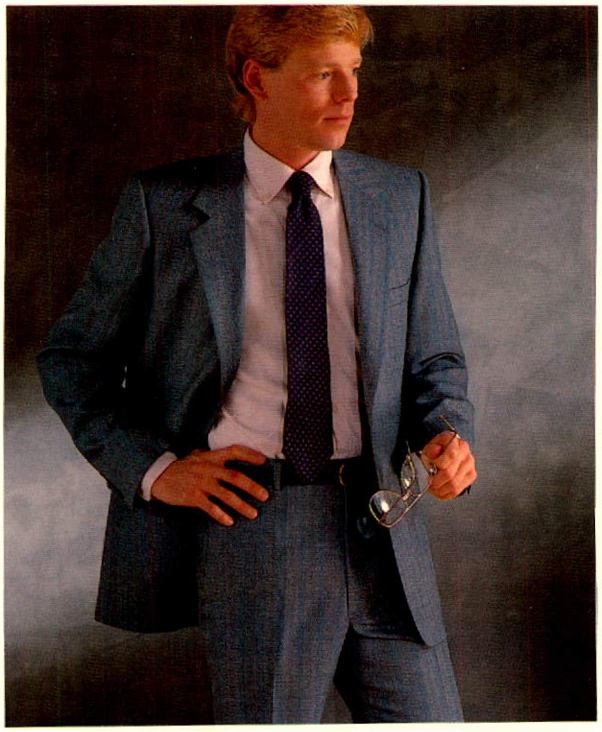
■ Abe Schrader restructured its product line to concentrate on such traditional areas of strength as dresses, sportswear and separates. *Schrader Separates* recently opened its new *Petite Sportswear* division. Additionally, the Schrader Knit Division responded to the re-emergence and redefinition of knits with a line of attractive one and two-piece garments that feature easy care characteristics.

■ College-Town focused on both the career and the casual needs of the junior-proportioned woman during the past year. The *College-Town* line concentrates on the young business woman looking for the quality reputation that the brand name has developed. The formation of *CT Sport* addresses the casual and comfort needs of the same consumer away from the business or professional environment.

Following Page:
Today, there are a total of 17 special features that make *London Fog* rainwear stand out. Many of these have been carried over to the outerwear line which was first developed in 1969 and has grown to make *London Fog* one of the leading manufacturers in this field.

■ **Campus**

■ **Devon**



■ **Biltwell**

MAJOR APPAREL BRANDS

FOR MEN:

Big Yank
Campus
Campusport
Chuck's
Clipper Mist
Converse
Cowden
Cowden Genes
Donegal
Ed McMahon
J J Cochran
John Alexander
Le Tigré
London Fog
London Towne
Maincoats
Outdoors Unlimited
Prince Bellini
Private Line
Rough Rider
Rugged Country
Sportabouts
Startown
Tailor's Bench
Tempo Europa
Tour de France
Winning Edge

FOR WOMEN:

Abe Schrader
Blake
Candie's
C'est Petite
Chuck's
College-Town
Converse
Cowden
Cowden Genes
CT Sport
Devon
It's Pure Gould
John Alexander
Lady Devon
London Fog
London Towne
Mallory & Crew
Maincoats
Ms. Blake
Outdoors Unlimited
Pant-her
The Petite Concept
Queen Casuals
REJOICE!
Schrader Sport Dresses
Schrader Sport Separates
Smith & Jones
Smith & Jones For Her
Smith & Jones Petites
Stuffed Shirt
Tour de France
Two Rivers
Vivaldi
Winning Edge

■ **College-Town**

■ **Big Yank**

GENERAL RETAIL MERCHANDISING GROUP

Founded in 1904, Central Hardware was a pioneer in the hardware retailing industry. It was an originator of the "super-market" approach for marketing hardware and construction related products through its development of the do-it-yourself, home-improvement center concept. Featured above is one of Central Hardware's first home-improvement centers.

INTERCO's General Retail Merchandising group achieved its most positive performance in eight years during fiscal 1987, while providing consumers with value-oriented products and services in a convenient and pleasant shopping environment. Major developments during the year strengthened the group's operating companies, refining their marketing efforts and improving their ability to contribute to INTERCO's continued growth:

■ Central Hardware intensified its dedication to strong customer service, solidifying its leadership position in the metropolitan markets it serves. Central's in-house Credit Program and *Mr. Tinker* hotline were expanded during the year, and intensive training programs were undertaken with all sales personnel to ensure that customers received the best possible service. Importantly, Project Planning Centers were introduced into all of Central Hardware's stores. At these centers, customers receive expert assistance on major projects—including the preparation of plans, advice on selecting appropriate material and equipment, and help in ordering the necessary supplies. The Centers also help emphasize the unique combination of expert assistance, extensive inventory and competitive prices that make Central Hardware the do-it-yourself leader in each of its markets.

■ Fine's achieved substantial sales gains during the year. An important factor in achieving this outstanding record was the installation of state-of-the-art point of sale computer terminals. Through the use of these terminals which provide detailed reports of all transactions on a daily basis for instant analysis, market conditions and sales trends were closely monitored and inventory replenished on a timely basis to respond to shifts in consumer demand. Given the flexibility demanded by the 18 to 35 year-old male customers served by Fine's, the terminals have proven to be an important merchandising tool. During the year, Fine's increased its presence in the growing North Carolina market with the addition of five new stores.

■ United Shirt also achieved significant sales gains during fiscal 1987. The company's strong growth reflected its ability to merchandise aggressively its products in the growing and increasingly diverse jeanswear market through its *Jeans Galore* retail stores. United also opened several Big and Tall departments, a move into a potential new market segment for this operating company.

■ Sky City intensified its store renovation and modernization program. This effort provides an entirely new and contemporary selling environment, featuring new fixtures, signage and floor patterns, at selected high-volume stores. The program will continue during the coming year, as will the installation of point-of-sale computer terminals.

■ Golde's responded to evolving market conditions by undertaking a program to upgrade and better target the merchandise offered in its stores. In order to provide these stores with greater identity, some departments were discontinued, with additional floor space devoted to brand name, upscale apparel products. Through remodeling and a more effective use of displays, customers have been provided with an improved shopping environment.

Following Page:
Central Hardware's St. Peters, Missouri center, which was opened in 1985, embodies the latest approaches toward providing shopping convenience, with a wide selection of products and outstanding customer service.


PLUMBING
17
B
A
SHOWER ACC.
SINKS
FAUCETS
PLASTIC FITTINGS
GALV. FITTINGS
COPPER FITTINGS
16
AUTOMOTIVE
ELECTRIC
HOUSEWARES
GARDEN
PAINT


HARDWARE
C 14 D
C 15 D
C 16
PLASTIC PIPE
PIPE
PUMPS

■ **Sky City**

■ **Fine's**

■ **United Shirt**

■ **Golde's**

MAJOR RETAIL TRADING NAMES

Central Hardware
Fine's
Golde's
Jeans Galore
Sky City Discount Center
United Shirt

FOOTWEAR MANUFACTURING AND RETAILING GROUP

The INTERCO companies competing in the footwear market relied on outstanding quality and new product introductions to improve their performance during fiscal 1987. These efforts were assisted by stronger market conditions as the year progressed.

The Florsheim product line continued to expand, with new offerings responding to consumer demand for casual and dress casual shoes providing superior styling, comfort and performance. This trend is expected to continue during the new year, with growth in dress moccasins and strong demand for basic dress footwear at popular price points.

A major development was the introduction of a new collection under the *Comfortech* label. Combining Florsheim's traditional quality and craftsmanship with advanced comfort technology and materials, this line of dress shoes offers outstanding comfort and initial consumer acceptance has been exceptional.

Similarly, a new line of Florsheim footwear for career women was well received during its introduction, and sustained growth is expected as new styles are added into the *Florsheim Thayer McNeil* stores during the coming months.

In the retail division, sales of Florsheim shoes benefited from the use of the new Retail Automated Merchandising System (RAMS) which ensures a more balanced store inventory. Performance of the *Florsheim Shops* was aided by a continually improving merchandise mix, upgrading or elimination of marginal or non-profitable locations, and tightened control of operating expenses to achieve better financial results.

There is opportunity for further improving the profitability of our footwear retailing operations in the identification and implementation of steps designed to increase sales productivity per square foot of floor space and per dollar of investment. A major thrust in this direction is *Express Shop*, the Florsheim electronic retailing program. Based upon the favorable results achieved this past year, a substantial expansion of this new retailing concept during the next 12 to 18 months is planned.

Since its beginning, The Florsheim Shoe Company has stressed craftsmanship, style, comfort and durability as depicted in the above turn of the century advertisement.

International Shoe directed its product research efforts to place additional emphasis on comfort in the workplace, developing a line of premium quality men's work shoes and boots under the *Footrests by Hy-Test* brand name. Featuring special cushions and new combinations of materials, these products offer lasting value to customers searching for on-the-job comfort in a physically demanding work environment.

The new *America's Tradesman* line offers three and six-inch height boots designed to provide maximum comfort and durability for the construction industry. The line will be sold through direct mail to better serve the highly mobile construction worker.

A merchandising innovation was introduced early in fiscal 1988 with the *Hy-Test Care Package* insurance program, which offers the industrial worker specified insurance protection in the event of a severe foot injury while wearing *Hy-Test Safety Shoes* on the job.

Following Page:
By adhering through the years to its original standards for product style and quality, The Florsheim Shoe Company has built a reputation as one of the world's premium footwear manufacturers.


The Royal Imperial
FLORSHEIM SHOE


COMFORTECH
BY FLORSHEIM

■ **Florsheim**

■ **Senack**

■ **Florsheim**

■ **International Shoe**

MAJOR FOOTWEAR BRANDS

FOR MEN:

Ambassador
America's Tradesman
Apple
Christian Dior
Converse
Converse All Star
Florsheim
Florsheim Designer Collection
Florsheim Imperial
Florsheim Royal Imperial
Florsheim Comfortech
Florsheim Idlers
Footrests
Hamptons by Converse
Weeds from Florsheim
Hy-Test
Julius Marlow
Outdoorsman
Pro Action by Florsheim
Sea Tracs by Florsheim
Winthrop
Worthmore
X-Statics

FOR WOMEN:

Accent
Akimbo
Avenues
Converse
Converse All Star
Eclaire
Florsheim
Florsheim Ramblers
Florsheim Signature
Hamptons by Converse
J. G. Hook
Marshmallows
Suite 200
Thayer McNeil
Velvet Step
X-Statics

MAJOR RETAIL TRADING NAMES

Florsheim Shoe Shops
Florsheim Thayer McNeil
Thompson, Boland & Lee
Express Shop

FURNITURE AND HOME FURNISHINGS GROUP

Ethan Allen created the furniture gallery concept 40 years ago. It was conceived as a unique approach to providing superior home decorating services to its customers. These galleries display integrated and correlated collections of furniture, accessories, floor and wall coverings, draperies and other furnishings necessary to provide a complete decorating service. Shown above is the first Ethan Allen gallery established in 1947.

Demographic factors, together with a favorable interest rate environment, kept new housing starts and sales of existing homes at good levels. These factors enabled the Furniture and Home Furnishings Group to generate strong performance based on a combination of quality products and outstanding professional interior design services.

With the growing number of two-career families, a larger percentage of households have increased amounts of income available for the purchase of quality furniture. Moreover, many couples that postponed having children while both husband and wife were beginning their careers are now raising families, requiring larger homes and additional furniture and home furnishings.

All of these factors contributed to increased sales for both Ethan Allen and Broyhill during the year. Additional growth was achieved by the acquisition of Highland House, Inc. Headquartered in Hickory, North Carolina, Highland House is a manufacturer of a broad line of quality upholstered furniture, all sold under the *Highland House of Hickory, Inc.* name.

Ethan Allen continued to set industry standards for customer service through its network of exclusive dealers. Based on their professionalism, Ethan Allen is able to offer the furniture buying public comprehensive decorating service and assistance in creating an entire home environment that reflects the personal taste and lifestyle of each customer. This unique capability was enhanced at mid-year with the introduction of Ethan Allen's Standards of Operation program . . . providing dealers with a more complete line of home furnishings, lamps, clocks, textiles, floor coverings, wall decor and accessory items than ever before, thus enabling them to meet more fully their customers' needs. Home and the quality of family life remain as Ethan Allen's primary objectives.

Major new Ethan Allen offerings included:

- A broadened collection of American contemporary bedroom, dining room and living room furniture marketed under the *Canova* brand. Integrated with *Canova* are coordinating fabrics, wall decor, lighting and accessories.

- An expanded English oak collection of furniture and coordinated home furnishings presented under the *Canterbury Oak* name.

■ A vastly enlarged collection of wall decor, lamps, accessories, rugs, clocks and textiles to coordinate with all *Ethan Allen* furniture collections.

Broyhill continued to strengthen its position in the marketplace through expansion of its Showcase Gallery Program to over 230 galleries. Sixty new locations are planned for the coming year. It also intensified the Broyhill Independent Dealer Program with improved advertising, merchandising and support services to aid smaller dealers in achieving increased sales. Both these efforts reflect Broyhill's recognition that a strong retail network is key to greater market penetration.

Products introduced by Broyhill during the year included:

■ The *Goodnight Sleeper*, a line of quality sleeper sofas featuring an improved conversion mechanism and extra thick coil spring mattress, while providing increased comfort for both seating and sleeping purposes.

■ Freestanding entertainment centers and fully integrated entertainment wall units to meet a rapidly growing consumer demand for the use and attractive storage of the latest electronic innovations.

■ The *Valley Forge Collection*, offering a fresh approach to country styling in natural or cherry finish on solid pine wood. Providing consumers an upscale look at attractive price points, the line has proven popular with suite and item buyers alike.

■ The *American Traditions* collection gives consumers a choice of "high style" or "down home" looks through decorator-inspired washed oak or warm country oak finishes. This line capitalizes on the increased importance of country styling in the casegoods and upholstery product categories.

Following Page:
From the original gallery location, the Ethan Allen concept has grown to more than 300 Georgian style Ethan Allen galleries which feature, on an exclusive basis, the complete line of products and services offered by Ethan Allen.


Ethan Allen
Georgetown Manor
AMERICAN TRADITIONAL INTERIORS
MON·THUR·FRI 10:00-9:00
TUES·WED·SAT 10:00-5:30
SUNDAYS 1:00-5:00


N
S
Ethan Allen

■ **Broyhill**

■ **Highland House**

■ **Ethan Allen**

■ **Highland House**

MAJOR FURNITURE AND HOME FURNISHINGS BRANDS

Broyhill
Broyhill Premier
Ethan Allen
Highland House of Hickory, Inc.
Kling
Knob Creek
Lenoir House
Restocrat

MAJOR RETAIL TRADING NAMES

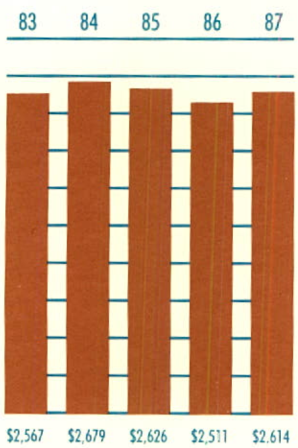
Broyhill Showcase Gallery
Carriage House
Georgetown
Georgetown Manor
Manor House

■ **Broyhill**

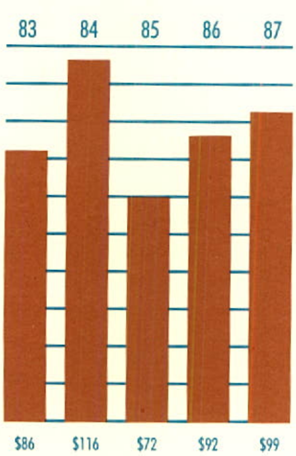
■ **Ethan Allen**

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

Net Sales
(In Millions)



Net Earnings
(In Millions)



RESULTS OF OPERATIONS

This discussion supplements the detailed information presented in the consolidated financial statements and footnotes which begin on page 38.

■ Net Sales

Net sales for fiscal 1987 were $2.61 billion, an increase of 4.1% from the $2.51 billion reported in fiscal 1986. Net sales for fiscal 1986 decreased 4.4% from the $2.63 billion reported in fiscal 1985. The increase in fiscal 1987 was principally attributable to the acquisition of Converse. On a comparative basis, excluding Converse, net sales were level with the prior year. Sales in the Furniture and General Retail Groups showed good gains. Sales for the Footwear Group, excluding Converse, were even with the prior year, while the Apparel Group was affected by the continuing adverse factors confronting the domestic apparel industry. The decrease in fiscal 1986 and fiscal 1985 was attributable, principally, to the Company's asset redeployment program. Excluding the effect of the asset redeployment program, sales for fiscal 1986 would have declined by 0.8% and sales for fiscal 1985 would have risen by 1.3%.

■ Other Income, Net

Other income decreased by 9.9% in fiscal 1987 to $29.0 million. The decrease was due to the inclusion of gains on sales of marketable securities in fiscal 1986 which were not present in fiscal 1987. For fiscal 1986, other income increased by 1.2%.

■ Gross Margins

Gross margins for fiscal 1987 were $827.0 million, or 31.6% of net sales, as compared to $785.4 million, or 31.3% and $811.8 million, or 30.9% for fiscal 1986 and 1985, respectively. For fiscal 1987, the General Retail and Furniture Groups continued to show improved gross margins, while the Apparel Group was affected by direct sourcing by many retailers, fewer advance seasonal orders by major chains and deflationary price trends. The improvement in fiscal 1986 was principally attributable to higher gross margins in the General Retail Group when compared to fiscal 1985, and the benefit of cost reduction programs. In fiscal 1985 margins were unfavorably affected by a higher level of promotions and discounting by retailers industry-wide, particularly in apparel and footwear products, shorter manufacturing runs which adversely affected production efficiencies and start-up costs associated with new product introductions.

■ Selling, General and Administrative Expenses

Selling, general and administrative expenses were $639.7 million, $613.2 million and $638.2 million for fiscal 1987, 1986 and 1985, respectively. As a percent of sales, selling, general and administrative expenses were 24.5% for fiscal 1987, as compared to 24.4% for fiscal 1986 and 24.3% for fiscal 1985. Expenses have remained fairly constant as a percent of sales due to stringent cost and expense control programs implemented at all operating levels of the company.

■ Interest Expense

Interest expense in fiscal 1987 amounted to $28.1 million compared to $25.5 million and $26.4 million in fiscal 1986 and 1985, respectively. The increase in fiscal 1987 was due to higher levels of short-term borrowings, primarily related to the Converse acquisition, partially offset by reductions in interest on long-term debt and capital lease obligations. The decline in fiscal 1986 was attributable to a reduction in the level of long-term debt.

■ Income Taxes

The effective tax rate for fiscal 1987 was 47.6% compared to 48.4% and 49.9% in fiscal 1986 and 1985, respectively. The fiscal 1987 effective tax rate decrease was due to the initial effects of the 1986 Tax Reform Act for certain subsidiaries, utilization of net operating loss carryforwards and the favorable effect of manufacturing operations in Puerto Rico. The fiscal 1986 rate benefited favorably from certain capital gains.

■ Earnings Per Share

Earnings per share for fiscal 1987 were $3.13, an increase of 7.2% from the $2.92 in fiscal 1986 which reflected a 31.2% increase from fiscal 1985. The increase for fiscal 1987 reflects the substantial improvement in earnings for the General Retail and Furniture Groups as well as the operations of Converse from date of acquisition. The increase in earnings per share in fiscal 1986 reflected the improvement of the General Retail Group and increased results of the Furniture and Home Furnishings Group, particularly in the second half of the year. The earnings in fiscal 1985 were impacted by a charge of $0.62 per share to cover the estimated costs and expenses associated with the asset redeployment program. Excluding this charge, fiscal 1986 earnings per share increased by 2.8%.

FINANCIAL CONDITION

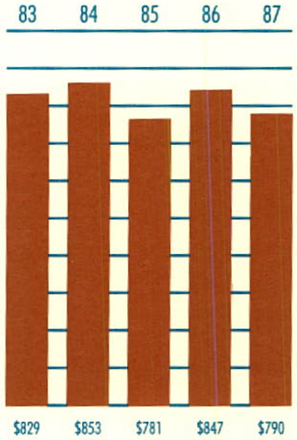
The company's financial position continues to be strong.

■ Working capital, the excess of current assets over current liabilities, was $789.9 million at the end of fiscal 1987. The current ratio was 3.4 to 1 at February 28, 1987.

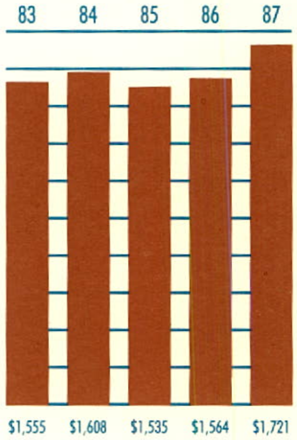
■ Cash and short-term investments totaled $27.2 million at year end, a decrease of $83.1 million from the prior year. At year end, short-term borrowings amounted to $68.8 million as compared to no borrowings last year. The decrease in cash and increase in borrowings of $151.9 million was utilized in the purchase of various companies, including Converse. In addition, $108 million in cash generated from operations was utilized for capital expenditures, stock repurchases and dividends.

■ Accounts receivable were $378.6 million at February 28, 1987, an increase of $45.0 million, or 13.5% from the prior year. Excluding the effect of Converse, accounts receivable would have been level with the prior year.

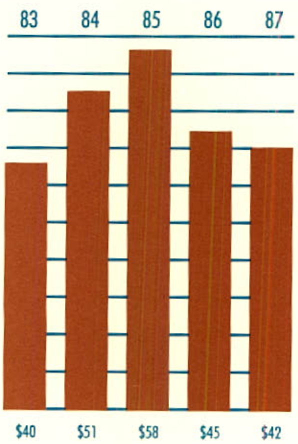
Working Capital
(In Millions)



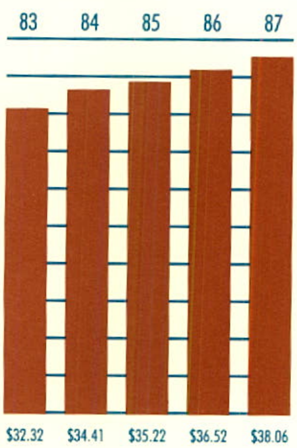
Total Assets
(In Millions)



Capital Expenditures
(In Millions)



Book Value Per Share



- Inventories were $692.6 million, an increase of $83.6 million, or 13.7% from the prior year. On a comparative basis, excluding the effect of acquired companies, inventories would have increased less than 1%, reflecting the company's continued emphasis on inventory control and improved turnover.

- Accounts payable and accrued expenses increased $33.4 million, reflecting the acquisition of Converse.

- Long-term debt and obligations under capital leases amounted to $185.6 million at February 28, 1987, an increase of $1.7 million during the year. The debt-to-capitalization ratio was 13.9% as compared to 14.2% last year.

Financing Arrangements

At fiscal year-end, the company had short-term borrowings of $68.8 million. To meet short-term working capital requirements, the company has revolving credit agreements enabling it to borrow up to $150 million in domestic and Euro-Dollar loans through 1995 and $50 million in Euro-Dollar loans through 1992. These credit facilities are primarily intended to support commercial paper borrowings. The company also maintains other bank lines of credit as credit availability and additional support for the sale of commercial paper. The company assumed a revolving credit agreement in the acquisition of Converse which, at February 28, 1987, provided for borrowings up to $15 million.

Capital Expenditures

The company maintains formalized procedures for the review of capital expenditures. These include return on investment and project pay-back analyses. Capital expenditures, for company-owned and capitalized leased property, aggregated $236.6 million during the last five years, of which $42.3 million occurred in fiscal 1987. Cash flow from operations provides the principal source of funds for capital expenditures. For fiscal 1988, capital expenditures are forecast to be approximately $60 million, with depreciation at about the same level.

Dividends

Cash dividends of $49.8 million were paid during the fiscal year, with $44.9 million to holders of common stock and the remainder to holders of preferred stock. The quarterly dividend rate on common stock is $0.40 per common share, or an annual indicated rate of $1.60 per common share.

Income Tax Effect of the Tax Reform Act

The Tax Reform Act of 1986, while reducing Federal income tax rates, provided for increases in the lives of newly acquired assets for tax depreciation purposes and repealed the investment tax credit. These latter two changes are not expected to have a material impact on the Company's future capital spending program.

Additionally, under an accounting change proposed by the Financial Accounting Standards Board, the deferred tax liability would be reduced to the amount which would be owed under the new tax law, with the benefit recorded through earnings. The proposed accounting change is expected to be finalized in fiscal 1988.

INTERCO CONSOLIDATED FINANCIAL STATEMENTS

Contents

CONSOLIDATED BALANCE SHEET

(Dollars in thousands)

Assets	February 28, 1987	February 28, 1986	February 28, 1985
Current assets:			
Cash	**$ 15,810**	$ 12,194	$ 12,992
Marketable securities	**11,425**	98,123	32,465
Receivables, less allowances of $18,342 ($17,768 in 1986 and $16,834 in 1985)	**378,615**	333,553	335,258
Inventories	**692,637**	609,017	615,267
Prepaid expenses and other current assets	**24,114**	21,039	30,789
Total current assets	**1,122,601**	1,073,926	1,026,771
Property, plant and equipment:			
Land	**30,557**	25,015	25,071
Buildings and improvements	**413,161**	387,340	375,168
Machinery and equipment	**309,523**	269,911	256,761
	753,241	682,266	657,000
Less accumulated depreciation	**314,676**	287,224	255,908
Net property, plant and equipment	**438,565**	395,042	401,092
Other assets	**159,546**	94,872	107,378
	$1,720,712	$1,563,840	$1,535,241

See accompanying notes to consolidated financial statements.

Liabilities and Shareholders' Equity	**February 28, 1987**	February 28, 1986	February 28, 1985
Current liabilities:			
Notes payable	**$ 68,840**	$ —	$ —
Current maturities of long-term debt and capital lease obligations	**11,915**	9,647	20,889
Accounts payable	**159,214**	138,652	148,298
Accrued employee compensation	**37,312**	36,928	38,582
Other accrued expenses	**45,982**	33,530	33,959
Income taxes	**9,446**	7,987	3,710
Total current liabilities	**332,709**	226,744	245,438
Long-term debt, less current maturities	**135,019**	127,409	133,311
Obligations under capital leases, less current maturities	**50,546**	56,495	61,403
Other long-term liabilities	**53,490**	41,899	30,325
Shareholders' equity:			
Preferred stock, no par value, authorized 10,000,000 shares—issued 617,946 shares in 1987, 660,273 shares in 1986 and 733,037 shares in 1985	**61,795**	66,027	73,304
Common stock, $3.75 stated value, authorized 100,000,000 shares—issued 32,030,210 shares in 1987, 31,743,384 shares in 1986 and 31,227,050 shares in 1985	**120,113**	119,038	117,102
Capital surplus	**107,905**	102,380	91,496
Retained earnings	**955,610**	905,587	863,019
	1,245,423	1,193,032	1,144,921
Less 3,464,957 (3,122,928 and 3,073,830 in 1986 and 1985, respectively) shares of common stock in treasury, at cost	**96,475**	81,739	80,157
Total shareholders' equity	**1,148,948**	1,111,293	1,064,764
	$1,720,712	$1,563,840	$1,535,241

CONSOLIDATED STATEMENT OF EARNINGS
(Dollars in thousands except per share data)

Years Ended	**February 28, 1987**	February 28, 1986	February 28, 1985
Income:			
Net sales	**$2,613,739**	$2,510,740	$2,625,746
Other income, net	**29,043**	32,230	31,852
	2,642,782	2,542,970	2,657,598
Costs and expenses:			
Cost of sales	**1,786,779**	1,725,343	1,813,934
Selling, general and administrative expenses	**639,741**	613,249	638,151
Interest expense	**28,082**	25,523	26,400
Asset redeployment expenses	**—**	—	35,010
	2,454,602	2,364,115	2,513,495
Earnings before income taxes	**188,180**	178,855	144,103
Income taxes	**89,537**	86,508	71,940
Net earnings	**$ 98,643**	$ 92,347	$ 72,163
Earnings per share	**$3.13**	$2.92	$2.22

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

(Dollars in thousands)

Years Ended	February 28, 1987	February 28, 1986	February 28, 1985
Working capital provided by:			
Net earnings	$ 98,643	$ 92,347	$ 72,163
Items not affecting working capital:			
Depreciation	47,806	44,853	44,643
Other, net	8,237	13,860	5,886
Operations	154,686	151,060	122,692
Disposal of property, plant and equipment	4,722	5,922	24,177
Issuance of preferred stock	—	249	17
Issuance of common stock	8,276	13,412	9,381
Additions to long-term debt	253	158	12,919
Additions to capital lease obligations	735	1,409	2,337
Other, net	7,377	10,058	—
	176,049	182,268	171,523
Working capital used for:			
Cash dividends	49,839	49,094	50,330
Additions to property, plant and equipment:			
Company owned property	41,581	43,362	56,023
Capitalized leased property	735	1,409	2,337
Reduction of long-term debt	36,157	6,537	19,137
Reduction of capital lease obligations	6,684	6,317	11,724
Purchase of common-treasury shares	15,691	2,250	58,057
Retirement of preferred stock	1,521	—	—
Conversion of preferred stock	3,432	7,450	6,924
Purchase of marketable securities	15,354	—	—
Other, net	—	—	19,386
	170,994	116,419	223,918
Acquisitions (less working capital of $110,731 in 1987 and $19,126 in 1985):			
Properties	53,719	—	4,062
Long-term debt and capital lease obligations	(43,514)	—	(1,788)
Excess of cost over fair value of net assets acquired	35,049	—	16,695
Other, net noncurrent assets	17,091	—	150
Net noncurrent assets	62,345	—	19,119
	233,339	116,419	243,037
Increase (decrease) in working capital	$ (57,290)	$ 65,849	$ (71,514)
Working capital increased (decreased) by:			
Cash and marketable securities	$ (83,082)	$ 64,860	$ (81,142)
Receivables	45,062	(1,705)	6,204
Inventories	83,620	(6,250)	(25,968)
Prepaid expenses and other current assets	3,075	(9,750)	8,135
Notes payable	(68,840)	—	—
Current maturities	(2,268)	11,242	(1,220)
Accounts payable and accrued expenses	(33,398)	11,729	8,638
Income taxes	(1,459)	(4,277)	13,839
	$ (57,290)	$ 65,849	$ (71,514)

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(Dollars in thousands except per share data)

	Preferred Stock	Common Stock Issued	Common Stock Treasury	Capital Surplus	Retained Earnings	Total
Balance February 29, 1984	$80,209	$115,652	$(22,775)	$ 84,242	$843,635	$1,100,963
Net earnings					72,163	72,163
Cash dividends:						
Preferred stock					(5,985)	(5,985)
Common stock–$1.515 per share					(44,345)	(44,345)
Conversion of debentures: Series D–189 shares	19			(2)		17
Conversion of preferred stock: Series D–69,237 shares	(6,924)	1,123		5,800		(1)
Exercise of stock options: Common–87,036 shares		327		1,469		1,796
Purchase of 1,921,000 common treasury shares			(58,057)			(58,057)
Issuance of 22,100 common treasury shares to ESOP			675	(13)		662
Foreign currency translations					(2,449)	(2,449)
Balance February 28, 1985	73,304	117,102	(80,157)	91,496	863,019	1,064,764
Net earnings					92,347	92,347
Cash dividends:						
Preferred stock					(5,405)	(5,405)
Common stock–$1.54 per share					(43,689)	(43,689)
Conversion of debentures: Series D–1,734 shares	173			76		249
Conversion of preferred stock: Series D–74,498 shares	(7,450)	1,208		6,241		(1)
Exercise of stock options: Common–194,222 shares		728		4,501		5,229
Purchase of 70,200 common treasury shares			(2,250)			(2,250)
Issuance of 21,102 common treasury shares to ESOP			668	66		734
Foreign currency translations					(685)	(685)
Balance February 28, 1986	66,027	119,038	(81,739)	102,380	905,587	1,111,293
Net earnings					98,643	98,643
Cash dividends:						
Preferred stock					(4,972)	(4,972)
Common stock–$1.57 per share					(44,867)	(44,867)
Retirement of preferred stock: Series D–8,000 shares	(800)			(721)		(1,521)
Conversion of preferred stock: Series D–34,327 shares	(3,432)	556		2,874		(2)
Exercise of stock options: Common–142,479 shares		519	171	3,378		4,068
Purchase of 366,200 common treasury shares			(15,691)			(15,691)
Issuance of 20,126 common treasury shares to ESOP			784	(6)		778
Foreign currency translations					1,219	1,219
Balance February 28, 1987	$61,795	$120,113	$(96,475)	$107,905	$955,610	$1,148,948

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands except per share data)

1. Significant Accounting Policies

The company and its subsidiaries follow generally accepted accounting principles to present fairly their consolidated financial position, results of operations, and changes in financial position. The major accounting policies of the company are set forth below.

■ **Principles of Consolidation**—The consolidated financial statements include the accounts of the company and all its subsidiaries, the majority of which are wholly owned. All material intercompany transactions have been eliminated in consolidation.

■ **Fiscal Year**—The company's fiscal year ends on the last day of February.

■ **Two-for-One Stock Split**—A two-for-one common stock split was effected July 23, 1986, to shareholders of record as of June 24, 1986. The number of shares and per share amounts included in the consolidated financial statements and notes thereto have been restated to retroactively reflect the stock split. The stated value per share of common stock was changed from $7.50 to $3.75.

■ **Marketable Securities**—Marketable equity securities (common and preferred stocks) are stated at the lower of cost or market. Aggregate net unrealized losses are included in results of operations if related to current assets and in shareholders' equity if related to noncurrent assets. Other marketable securities are stated at cost, which approximates market value, unless there is an indication of permanent impairment of value, in which case the adjustment to market value is included in results of operations. The cost of marketable securities sold is determined on the specific identification method.

■ **Inventories**—Inventories are stated at the lower of cost (first-in, first-out) or market, except for certain footwear manufacturing and general retail inventories which are valued on the "last-in, first-out" method of inventory valuation.

■ **Property, Plant and Equipment**—Property, plant and equipment, including facilities and equipment leased under capital leases, are stated at cost. Expenditures for improvements are capitalized, while normal repairs and maintenance are expensed as incurred. When properties are retired or otherwise disposed of, the related cost and accumulated depreciation or amortization are removed from the accounts and gains or losses on the dispositions are reflected in results of operations. For financial reporting purposes, the company utilizes both accelerated and straight-line methods of computing depreciation and amortization. Such expense is computed based on the estimated useful lives of the respective assets or term of lease, if less, which generally range from 15 to 40 years for buildings and improvements, and from 3 to 20 years for machinery and equipment. Approximately 80% of depreciation and amortization expense was computed using the straight-line method in each fiscal year presented.

■ **Excess of Cost Over Fair Value of Net Assets Acquired**—The excess of cost over fair value of net assets of companies acquired is included in other assets and is being amortized on a straight-line basis, with lives ranging from 25 to 40 years.

■ **Pension Plans**—For financial reporting purposes, the company's policy is to provide for current costs and amortization of prior service costs over 30 years. Amounts funded meet or exceed the funding requirements of the Employee Retirement Income Security Act of 1974.

(Dollars in thousands except per share data)

■ **Income Taxes**—Deferred income taxes are provided on transactions which are reported for financial reporting purposes in different periods than for income tax purposes. For periods prior to fiscal 1987, investment tax credits are reflected as a reduction of Federal income taxes in the period in which qualified property is placed in service. It is the company's intent that the undistributed earnings of its subsidiaries will either be reinvested in the subsidiaries or distributed tax-free to the parent company. Generally, no provision has been made for income taxes on such undistributed earnings.

2. Business Combinations

On September 8, 1986, the company acquired all the outstanding stock of Converse Inc., a leading manufacturer and supplier of athletic footwear. The acquisition price of $143,717, including capitalized expenses, was paid in cash, and accounted for as a purchase. Accordingly, Converse's operations have been included in the consolidated statements from the date of acquisition. The total acquisition cost exceeded the fair value of the net assets acquired by $28,781, and the excess has been allocated to goodwill. This acquisition is included in the Footwear Manufacturing and Retailing Segment of the company.

The following unaudited summary, prepared on a pro forma basis, combines the consolidated results of operations of the company for fiscal years 1987 and 1986, with those of Converse Inc. as if the transaction occurred at the beginning of fiscal 1986.

	1987	1986
Net sales	**$2,727,832**	$2,730,660
Net earnings	**$95,566**	$87,348
Earnings per share	**$3.03**	$2.76

The pro forma data has been adjusted, net of income tax effects, to reflect interest expense, depreciation and amortization of the fair value of assets acquired, and the excess of costs over fair value of net assets acquired.

Also, in fiscal 1987, the company made three smaller acquisitions for cash payments totaling $29,359. The results of operations of these purchased companies are not material to the consolidated statement of earnings.

3. Inventories

Inventories are summarized as follows:

	1987	1986	1985
Retail merchandise	**$234,943**	$236,326	$230,329
Finished products	**272,332**	209,455	201,478
Work in process	**55,251**	49,100	55,724
Raw materials	**130,111**	114,136	127,736
	$692,637	$609,017	$615,267

All of the major categories of inventory include certain items valued on the "last-in, first-out" method. Had the "first-in, first-out" method been applied to all inventories, they would have been stated at approximately $723,862, $640,874 and $648,656 at fiscal years 1987, 1986 and 1985, respectively.

4. Lines of Credit

The company's revolving credit agreement with a number of U. S. banks, which enabled it to borrow up to $100,000 in domestic or Euro-Dollar loans, expired on February 28, 1987. There were no borrowings outstanding under the agreement at fiscal years ended 1987, 1986 and 1985.

On March 10, 1987, the company entered into a new eight-year revolving credit agreement enabling it to borrow up to $150,000 from several U. S. banks. Under the agreement there are various borrowing options based on domestic and Euro-Dollar interest rates.

On April 6, 1987, the company entered into a five-year credit agreement enabling it to borrow up to $50,000 in Euro-Dollar loans from a group of foreign banks under various borrowing options based on Euro-Dollar interest rates.

In the acquisition of Converse Inc., the company assumed a revolving credit agreement which, at February 28, 1987, provided for borrowings up to $15,000. Aggregate borrowings under this agreement were $10,500 at fiscal 1987 year end.

The company also maintains other bank lines of credit which provide added credit availability and support for the sale of commercial paper. On February 28, 1987, the total unused lines of credit under these agreements were $58,000.

Average short-term borrowings outstanding during fiscal 1987, 1986 and 1985 were $57,000, $27,000 and $20,000, respectively, with a weighted average interest rate thereon of 6.1%, 7.8% and 10.4%, respectively. Maximum short-term borrowings at any month-end were $141,500, $41,000 and $33,000 in fiscal years 1987, 1986 and 1985, respectively.

5. Long-Term Debt

Long-term debt consisted of the following:

	1987	1986	1985
14¼% promissory notes due February 15, 1991	**$ 75,000**	$ 75,000	$ 75,000
8⅝% promissory installment note, payable $1,000 annually through 1993, and balance in 1994	**12,000**	13,000	14,000
5% to 12% industrial revenue bonds payable in varying amounts through 2011	**44,631**	37,132	37,651
Other debt at 4⅝% to 9% interest rates, payable in varying amounts through 2006	**11,307**	7,935	23,674
	142,938	133,067	150,325
Less current maturities	**6,460**	3,983	15,066
Less market adjustment	**1,459**	1,675	1,948
	$135,019	$127,409	$133,311

Maturities of long-term debt are $6,460, $2,109, $7,624, $81,670 and $1,469 for fiscal years 1988 through 1992, respectively.

The market adjustment relates to purchase adjustments of the long-term debt assumed in the acquisition of Ethan Allen, Inc.

The 14¼% promissory notes may be redeemed on February 15, 1988, at the principal amount, without premium.

The company is in compliance with the covenants of its debt agreements and does not believe that the covenants will restrict its future operations.

6. Obligations Under Capital Leases

The amount capitalized under capital leases is the lesser of the present value of the minimum lease payments or the fair value of the leased properties at the beginning of the respective lease terms. Generally, interest rates applicable to capital leases range between 4¾% and 16¾% for leased facilities and between 12% and 19% for leased equipment. Obligations under capital leases amounted to $56,001, $62,159 and $67,226 at fiscal years ended 1987, 1986 and 1985, respectively. Maturities of these obligations are $5,455, $5,458, $5,360, $5,437 and $5,040 for fiscal years 1988 through 1992, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

(Dollars in thousands except per share data)

7. Preferred Stock The company's preferred stock is issuable in series. At fiscal years ended 1987, 1986 and 1985, the outstanding preferred stock consisted of 617,946, 660,273 and 733,037 shares, respectively, of Series D $7.75 cumulative convertible with stated and involuntary liquidating value of $100.00 per share.

Each share of the Series D preferred stock is convertible into 4.3242 shares of the company's common stock. Subject to the satisfaction of certain conditions relating to common stock dividends paid, the Series D preferred stock may be redeemed at the company's option at $106.75 per share, decreasing to $104.75 per share on January 29, 1989. The Series D preferred stock may be redeemed at the company's option on or after January 29, 1989, at $104.75 per share, decreasing to $100.00 per share in 1994.

8. Common Stock Shares of common stock were reserved for the following purposes at February 28, 1987:

	Number of Shares
Common stock options:	
Granted	634,422
Acquired company options assumed	2,698
Available for grant	625,176
Conversion of preferred stock	2,672,122
	3,934,418

Under the company's stock option plans, certain key employees may be granted incentive options, nonqualified options, stock appreciation rights, or combinations thereof. Nonqualified options and stock appreciation rights granted under the 1977 Plan may not be less than 85% of the fair market value (100% as to incentive options and related stock appreciation rights) of the common stock on the date of grant. Options and stock appreciation rights granted under the 1980 and 1985 Plans may not be less than 100% of the fair market value of the common stock on the date of grant. All options which have been granted, incentive or nonqualified, were at 100% of fair market value on the date of grant. Incentive options and nonqualified options expire ten years after the date of grant. At February 28, 1987, no stock appreciation rights have been granted.

At February 28, 1987, information regarding options granted but not exercised was as follows:

	Option Shares Outstanding	Dates of Grant	Price Range
1977 Plan	61,444	November 17, 1978 —October 7, 1985	$17.50-36.75
1980 Plan	572,978	December 19, 1980 —January 21, 1986	$20.1875-34.375

Changes in options granted are summarized as follows:

	1987		1986		1985	
	Shares	**Average Price**	Shares	Average Price	Shares	Average Price
Beginning of year	**800,756**	**$26.85**	1,039,780	$26.28	663,848	$23.96
Assumed option of purchased company	**6,743**	**4.84**	—	—	—	—
Granted	—	—	11,500	33.17	531,900	28.12
Exercised	**(142,479)**	**24.21**	(194,222)	24.10	(87,036)	20.09
Cancelled	**(27,900)**	**27.82**	(56,302)	27.18	(68,932)	25.88
End of year	**637,120**	**27.17**	800,756	26.85	1,039,780	26.28
Exercisable at end of year	**283,197**		259,454		271,694	

In fiscal 1986, the company declared a dividend of one Common Share Purchase Right for each then outstanding share of common stock. In addition, one right has been or will be issued with each share of common stock issued by the company after October 4, 1985, and before the date the rights become exercisable, are redeemed by the company, or expire on October 4, 1990. The rights will not be exercisable, or transferable apart from the common stock, until ten days after another person or group of persons acquires 20% or more of the common stock or commences, or announces its intention to commence, a tender or exchange offer for 30% or more of the common stock. Each right entitles its holder to buy one share of common stock at an exercise price of $75.00. In certain circumstances, the rights will entitle their holders to purchase larger amounts of common stock or stock in an acquiring company. In addition to the shares reserved above, an additional 35,964,628 shares have been reserved under this plan.

9. Income Taxes

Income tax expense was comprised of the following:

	1987	1986	1985
Current:			
Federal	**$64,659**	$57,261	$68,583
State and local	**11,378**	10,104	10,438
Foreign	**2,441**	2,398	1,527
	78,478	69,763	80,548
Deferred	**11,059**	16,745	(8,608)
	$89,537	$86,508	$71,940
ESOP, investment and jobs tax credits	**$ 846**	$ 3,394	$ 3,074

The following table reconciles the differences between the Federal corporate statutory rate and the company's effective income tax rate:

	1987	1986	1985
Federal corporate statutory rate	**46.0%**	46.0%	46.0%
State and local income taxes, net of Federal tax benefit	**3.3**	3.2	4.3
ESOP, investment and jobs tax credits	**(0.4)**	(1.7)	(2.1)
Foreign taxes, including foreign currency translation effects	**0.1**	0.3	(0.2)
Other	**(1.4)**	0.6	1.9
Effective income tax rate	**47.6%**	48.4%	49.9%

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

(Dollars in thousands except per share data)

Certain items are recognized for income tax purposes in years other than those in which they are reported in the consolidated financial statements. Future income tax benefits and deferred credits at the end of each fiscal year are included in the accompanying consolidated balance sheet, as follows:

	1987	1986	1985
Prepaid expenses and other current assets	**$ 6,029**	$ 8,442	$16,823
Other long-term liabilities	**(30,881)**	(21,688)	(13,324)
	$(24,852)	$(13,246)	$ 3,499

The Federal income tax returns of the company and its major subsidiaries have been examined through fiscal 1984.

10. Employee Benefits

The company and its subsidiaries have pension plans covering substantially all employees, including certain employees in foreign countries. Total pension expense was $17,700, $17,100 and $17,600 in fiscal years 1987, 1986 and 1985, respectively. Accumulated plan benefits and plan net assets for the company's defined benefit plans as of the most recent valuation dates are presented below:

	1987	1986	1985
Actuarial present value of accumulated plan benefits:			
Vested	**$160,069**	$150,583	$143,846
Nonvested	**12,294**	10,427	10,182
	$172,363	$161,010	$154,028
Net assets (at market value) available for benefits	**$187,121**	$162,130	$146,358

The weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 7.7% in fiscal years 1987, 1986 and 1985.

During fiscal 1985, the company initiated a Savings Plan for Employees of INTERCO INCORPORATED and Affiliates and an INTERCO INCORPORATED Employee Stock Ownership Plan (ESOP). The total cost of these plans for fiscal years 1987, 1986 and 1985 was $638, $612 and $589, net of taxes of $1,242, $1,307 and $1,206, respectively.

The company provides certain health care and life insurance benefits for certain employees who reach retirement age. Retiree health and life insurance benefits are provided through insurance companies. Post-retirement health care and life insurance expense for fiscal years 1987, 1986 and 1985 was $1,407, $1,422 and $1,470, respectively.

11. Lease Commitments

Substantially all of the company's retail outlets and certain other real properties and equipment are operated under lease agreements expiring at various dates through the year 2022. Leases covering retail outlets and equipment generally require, in addition to stated minimums, contingent rentals based on retail sales and equipment usage. Generally, the leases provide for renewal for various periods at stipulated rates.

Assets recorded under capital leases were as follows:

	1987	1986	1985
Land	$ 783	$ 783	$ 783
Buildings	78,234	82,158	82,476
Machinery and equipment	9,029	9,360	10,660
	88,046	92,301	93,919
Accumulated depreciation	44,053	43,636	39,948
	$43,993	$48,665	$53,971

Future minimum lease payments under capital leases, reduced by minimum rentals from subleases of $4,199 at February 28, 1987, aggregate $95,757 of which $56,001 is included in obligations under capital leases and current maturities, $31,126 represents interest, and the balance represents other costs of the leases including taxes, insurance and maintenance. Annual payments under capital leases are $11,289, $10,733, $10,115, $9,694 and $8,818 for fiscal years 1988 through 1992, respectively.

Total rent expense was as follows:

	1987	1986	1985
Basic rentals under operating leases	$38,458	$35,858	$40,181
Contingent rentals, operating and capital leases	37,451	33,754	32,571
	75,909	69,612	72,752
Less sublease rentals	1,311	1,718	2,181
	$74,598	$67,894	$70,571

Included in rent expense above is the cost of services provided by lessors of leased retail departments, estimated to aggregate $18,500, $16,700 and $15,500 in fiscal years 1987, 1986 and 1985, respectively.

Future minimum lease payments under operating leases, reduced by minimum rentals from subleases of $5,799, at February 28, 1987, aggregate $199,379. Annual payments under operating leases are $34,232, $30,254, $26,014, $22,732 and $19,531 for fiscal years 1988 through 1992, respectively.

12. Litigation

The company is or may become a defendant in a number of pending or threatened legal proceedings in the ordinary course of business. In the opinion of management, the ultimate liability, if any, of the company from all such proceedings will not have a material effect upon the consolidated financial position.

13. Earnings Per Share

Earnings per share are based on the weighted average number of shares of common stock and common stock equivalents outstanding during the year, plus those common shares which would have been issued if conversion of all preferred stock and convertible debentures had taken place at the beginning of each year or since date of issuance. Stock options, the exercise of which would result in dilution of earnings per share, are considered common stock equivalents. Net earnings for these computations are increased by the net interest expense on the convertible debentures in fiscal 1986 and 1985. Primary earnings per share do not differ significantly from fully diluted earnings per share.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

(Dollars in thousands except per share data)

14. Business Segment Information

The company's four business segments are Apparel Manufacturing, General Retail Merchandising, Footwear Manufacturing and Retailing, and Furniture and Home Furnishings. Specific information, on an unaudited basis, relating to the operating companies and their products, which comprise each segment, is included on the inside front cover and on pages 6 through 33. Summarized financial information by business segment is as follows:

	1987	1986	1985
Net sales to unaffiliated customers:			
Apparel	$ 817,660	$ 907,833	$ 943,077
General Retail	498,324	461,785	545,322
Footwear	663,521	558,286	580,467
Furniture	634,234	582,836	556,880
Total	$2,613,739	$2,510,740	$2,625,746
Operating earnings:			
Apparel	$ 47,269	$ 66,716	$ 83,062
General Retail	40,610	32,085	17,277
Footwear	52,136	48,475	54,727
Furniture	75,913	57,285	53,882
	215,928	204,561	208,948
Asset redeployment expenses	—	—	(35,010)
Corporate expenses and interest cost	(27,748)	(25,706)	(29,835)
Earnings before income taxes	$ 188,180	$ 178,855	$ 144,103
Identifiable assets at year end:			
Apparel	$ 465,601	$ 456,972	$ 463,277
General Retail	248,639	234,004	235,697
Footwear	497,706	291,292	290,099
Furniture	472,400	455,145	454,580
	1,684,346	1,437,413	1,443,653
Corporate assets	36,366	126,427	91,588
Total	$1,720,712	$1,563,840	$1,535,241
Depreciation expense:			
Apparel	$ 12,123	$ 11,965	$ 11,316
General Retail	9,079	8,294	9,671
Footwear	10,638	8,286	7,976
Furniture	14,596	14,478	13,065
Capital expenditures:			
Apparel	$ 8,869	$ 13,433	$ 10,815
General Retail	8,167	6,169	14,338
Footwear	7,486	8,114	10,519
Furniture	16,181	16,235	19,646

On November 1, 1984, the company announced that it would accelerate its asset redeployment program under which certain operating divisions not meeting the long-term profitability requirements of the company would be sold or liquidated. To cover the estimated costs and expenses associated with the program, a pretax reserve of $35,010 ($20,000 after tax, or $0.62 per share) was provided in the third quarter ended November 30, 1984. Accordingly, the sales and earnings of the operating units involved in this program are not included in the results shown above for periods subsequent to September 1, 1984. If this program had been in effect for the entire year, net sales of the Apparel segment and the General Retail segment for fiscal 1985 would have been $936,633 and $457,866, respectively. Substantially all of the estimated expenses of the asset redeployment program were allocated to the General Retail segment. This program was completed in fiscal year 1987, and all operations, or the net assets of each, have been sold.

Sales between business segments, which account for less than 1% of the sales of any one business segment, are considered immaterial and are netted against the sales of the respective segment. Operating earnings of the business segment include its sales less all operating expenses. Minority interests in certain subsidiaries are immaterial and have been included in corporate expenses and interest cost. Substantially all of the company's sales are made to unaffiliated customers. No customer accounted for 10% or more of consolidated sales. Foreign operations are not material.

Identifiable assets are those assets used by each segment in its operations. Corporate assets consist primarily of cash and marketable securities. The remaining assets of the operating units involved in the asset redeployment program are included in corporate assets under identifiable assets at fiscal years ended 1986 and 1985. Realized gains (losses) on the sale of marketable securities netted against corporate expenses and interest cost amounted to $13, $4,345 and $(90) for fiscal years 1987, 1986 and 1985, respectively.

15. Quarterly Financial Information (Unaudited)

Following is a summary of unaudited quarterly information for each of the years in the three year period ended February 28, 1987.

	First	Second	Third	Fourth
Net Sales:				
1987	**$579,177**	**$625,677**	**$757,336**	**$651,549**
1986	588,954	644,022	694,704	583,060
1985	645,528	700,526	698,765	580,927
Gross Profit:				
1987	**$179,538**	**$197,722**	**$236,370**	**$213,330**
1986	177,067	200,747	208,031	199,552
1985	199,913	214,807	215,146	181,946
Net Earnings:				
1987	**$ 14,379**	**$ 23,470**	**$ 29,783**	**$ 31,011**
1986	11,204	23,212	27,032	30,899
1985	19,468	24,396	8,339	19,960
Earnings Per Share:				
1987	**$0.45**	**$0.75**	**$0.94**	**$0.99**
1986	0.35	0.74	0.86	0.97
1985	0.58	0.74	0.27	0.63
Common Dividends Paid Per Share:				
1987	**$0.385**	**$0.385**	**$0.40**	**$0.40**
1986	0.385	0.385	0.385	0.385
1985	0.36	0.385	0.385	0.385
Common Stock Price Range (High-Low):				
1987	**$45-37**	**$ 48-39**	**$47-38**	**$45-37**
1986	35-31	36-32	37-31	40-34
1985	31-28	31-28	30-28	33-29

The closing market price of INTERCO's common and preferred stock at fiscal year end 1987 was $42⅝ and $185¼ per share, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (CONT'D)

(Dollars in thousands except per share data)

Included in the fourth quarter of fiscal 1986 are certain favorable inventory adjustments approximating $7.0 million, net of tax, representing refinements of gross margin estimates used in the first three quarters of the year. Management believes such adjustments reflect the seasonality, fashion-consciousness, and promotional nature of certain of the markets served by the company.

16. Subsequent Events (Unaudited)

On April 13, 1987, the shareholders of the company approved the acquisition of all of the outstanding common stock of The Lane Company, Incorporated (Lane) in exchange for 1½ shares of the company's common stock. Lane designs, manufactures, and sells wooden, metal and upholstered furniture and related furniture parts, and will be included in the Furniture and Home Furnishings Segment of the company. The transaction will be accounted for on a pooling of interests basis in fiscal 1988, and, accordingly, historical financial data in future reports will be restated to include Lane. The following unaudited pro forma data summarizes the combined results of operations of the company and Lane as though the merger had occurred at the beginning of fiscal 1985.

	1987	1986	1985
Net sales	**$2,946,902**	$2,832,384	$2,910,680
Net earnings	**$125,497**	$119,231	$94,694
Earnings per share	**$2.91**	$2.77	$2.17

Also, the shareholders of the company approved an increase in the authorized common stock from 100 million to 125 million shares.

Independent Accountants' Report

The Board of Directors and Shareholders
INTERCO INCORPORATED:

We have examined the consolidated balance sheets of INTERCO INCORPORATED and subsidiaries as of February 28, 1987, 1986, and 1985 and the related consolidated statements of earnings, shareholders' equity, and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of INTERCO INCORPORATED and subsidiaries at February 28, 1987, 1986, and 1985 and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Peat Marwick Main & Co.

St. Louis, Missouri
April 6, 1987

FIVE YEAR CONSOLIDATED FINANCIAL REVIEW

(Dollars in thousands except per share data)

Years Ended	1987	1986	1985	1984	1983
For The Year					
Summary of operations:					
Net sales	**$2,613,739**	$2,510,740	$2,625,746	$2,678,886	$2,566,606
Cost of sales	**1,786,779**	1,725,343	1,813,934	1,820,366	1,759,527
Interest expense	**28,082**	25,523	26,400	31,662	35,072
Earnings before income taxes	**188,180**	178,855	144,103	221,021	165,876
As a percent of sales	**7.2%**	7.1%	5.5%	8.3%	6.5%
Income taxes	**89,537**	86,508	71,940	104,827	80,114
Net earnings	**98,643**	92,347	72,163	116,194	85,762
As a percent of sales	**3.8%**	3.7%	2.7%	4.3%	3.3%
Net earnings applicable to common stock	**98,643**	92,351	72,172	116,204	85,774
Per share of common stock:					
Earnings	**$3.13**	$2.92	$2.22	$3.51	$2.61
Dividends	**$1.57**	$1.54	$1.515	$1.44	$1.44
Average common and common equivalent shares outstanding (in thousands)	**31,541**	31,641	32,459	33,124	32,858
Cash dividends paid:					
On common stock	**$ 44,867**	$ 43,689	$ 44,345	$ 41,930	$ 41,018
On preferred stock	**$ 4,972**	$ 5,405	$ 5,985	$ 6,701	$ 7,478
At Year End					
Working capital	**$ 789,892**	$ 847,182	$ 781,333	$ 852,847	$ 828,842
Property, plant and equipment, net	**438,565**	395,042	401,092	408,365	409,973
Capital expenditures:					
Company owned property	**41,581**	43,362	56,023	47,627	36,144
Capitalized leased property	**735**	1,409	2,337	3,431	3,966
Total assets	**1,720,712**	1,563,840	1,535,241	1,607,832	1,554,975
Long-term debt	**135,019**	127,409	133,311	139,914	193,341
Obligations under capital leases	**50,546**	56,495	61,403	69,002	73,785
Shareholders' equity	**1,148,948**	1,111,293	1,064,764	1,100,963	1,023,231
Book value per common share	**$ 38.06**	$ 36.52	$ 35.22	$ 34.41	$ 32.32

BOARD OF DIRECTORS

Nathan S. Ancell
Chairman of the Board,
Ethan Allen Inc.

Ronald L. Aylward
Vice Chairman of the
Board of the Company

Zane E. Barnes
Chairman of the Board,
President and Chief Executive
Officer of Southwestern Bell
Corporation

Stanley M. Cohen
Retired Chairman of the Board,
Central Hardware Company

Harry M. Krogh
President and Chief Operating
Officer of the Company

Donald E. Lasater
Chairman of the Board and
Chief Executive Officer of
Mercantile Bancorporation, Inc. and
Chairman of the Board of
Mercantile Bank, National Association

Marilyn S. Lewis
Civic leader and volunteer

Lee M. Liberman
Chairman of the Board,
President and Chief
Executive Officer of
Laclede Gas Company

Mark H. Lieberman
President, Londontown

Thomas H. O'Leary
Vice Chairman of the Board,
Burlington Northern Inc.

Robert H. Quenon
President and Chief Executive
Officer of Peabody Holding Co., Inc.

Charles J. Rothschild, Jr.
President, Campus Sportswear Company

Harvey Saligman
Chairman of the Board and
Chief Executive
Officer of the Company

Executive Committee
Harvey Saligman, Chairman
Ronald L. Aylward
Harry M. Krogh
Donald E. Lasater

Audit Committee
Zane E. Barnes, Chairman
Donald E. Lasater
Marilyn S. Lewis
Lee M. Liberman
Thomas H. O'Leary

Executive Compensation and Stock Option Committee
Donald E. Lasater, Chairman
Zane E. Barnes
Lee M. Liberman
Thomas H. O'Leary

Nominating Committee
Zane E. Barnes, Chairman
Ronald L. Aylward
Donald E. Lasater
Thomas H. O'Leary
Harvey Saligman

CORPORATE OFFICERS

Harvey Saligman
Chairman of the Board and
Chief Executive Officer

Ronald L. Aylward
Vice Chairman of the Board

Harry M. Krogh
President and Chief
Operating Officer

Eugene F. Smith
Senior Vice President,
Finance

J. Carl Powers
Vice President

Charles J. Rothschild, Jr.
Vice President

Nathan S. Ancell
Vice President

Mark H. Lieberman
Vice President

Duane A. Patterson
Secretary

Robert T. Hensley, Jr.
Treasurer

Stanley F. Huck
Controller

Keith E. Mattern
General Counsel and
Assistant Secretary

James K. Pendleton
Assistant Secretary

William R. Withrow
Assistant Treasurer

Russell L. Baumann
Assistant Controller

OPERATING BOARD

Harvey Saligman
Chairman of the Board and Chief Executive Officer of the Company

Ronald L. Aylward
Vice Chairman of the Board of the Company

Harry M. Krogh
President and Chief Operating Officer of the Company

Eugene F. Smith
Senior Vice President, Finance of the Company

Nathan S. Ancell
Chairman of the Board, Ethan Allen Inc.

Edwin J. Baum
President, The Biltwell Company, Inc.

Lionel Baxter
President, Big Yank Corporation

James H. Cohen
President, Central Hardware Company

Webster L. Cowden, Jr.
President, Cowden Manufacturing Company

Herschel Cravitz
President, Queen Casuals, Inc.

Barry S. Fine
Chairman of the Board, Fine's Men's Shops, Incorporated

Carl E. Gunter
President, Broyhill Furniture Industries, Inc.

Mark H. Lieberman
President, Londontown

Richard B. Loynd
Chairman of the Board, Converse Inc.

Stanley Matzkin
Chairman of the Board, Devon Apparel

Ronald J. Mueller
President, The Florsheim Shoe Company

Don B. Olesen
President, International Hat Company

Carl D. Packer
Chairman of the Board, College-Town

Robert B. Peterson
Chairman of the Board, Sky City Stores, Inc.

J. Carl Powers
President, International Shoe Company

Charles J. Rothschild, Jr.
President, Campus Sportswear Company

Morton J. Schrader
President, Abe Schrader Corporation

Irving S. Wahl
Chairman of the Board, Stuffed Shirt Inc.

PRINCIPAL COMPANIES OF INTERCO

Apparel Manufacturing Group

Abe Schrader Corporation
New York, New York

Big Yank Corporation
New York, New York

The Biltwell Company, Inc.
St. Louis, Missouri

Campus Sportswear Company
Paramus, New Jersey

College-Town
Braintree, Massachusetts

Cowden Manufacturing Company
Lexington, Kentucky

Devon Apparel
Philadelphia, Pennsylvania

International Hat Company
St. Louis, Missouri

Londontown
Eldersburg, Maryland

Queen Casuals, Inc.
Philadelphia, Pennsylvania

Stuffed Shirt Inc.
New York, New York

General Retail Merchandising Group

Central Hardware Company
St. Louis, Missouri

Fine's Men's Shops, Incorporated
Norfolk, Virginia

Golde's Department Stores, Inc.
St. Louis, Missouri

Sky City Stores, Inc.
Asheville, North Carolina

United Shirt Distributors, Inc.
Detroit, Michigan

Footwear Manufacturing and Retailing Group

Converse Inc.
North Reading, Massachusetts

The Florsheim Shoe Company
Chicago, Illinois

International Shoe Company
St. Louis, Missouri

Senack Shoes, Inc.
St. Louis, Missouri

Furniture and Home Furnishings Group

Broyhill Furniture Industries, Inc.
Lenoir, North Carolina

Ethan Allen Inc.
Danbury, Connecticut

SHAREHOLDER INFORMATION

Transfer Agents
(Common and Preferred Stock)
Mercantile Bank, National Association
St. Louis, Missouri 63166
(314) 425-2755

Morgan Shareholder Services
Trust Company
New York, New York 10249
(212) 587-6434

Registrars
(Common and Preferred Stock)
Centerre Trust Company
St. Louis, Missouri 63178
(314) 231-9300

Morgan Shareholder Services
Trust Company
New York, New York 10249
(212) 587-6434

Dividend Disbursing Agent
(Common and Preferred Stock)
Mercantile Bank, National Association
St. Louis, Missouri 63166
(314) 425-2755

Independent Accountants
Peat Marwick Main & Co.
St. Louis, Missouri 63101

Exchange Listings
Common and Preferred Shares and 14¼% Notes are listed on the New York Stock Exchange. Common Shares are also listed on the Midwest Stock Exchange. (Trading symbol: ISS)

Corporate Offices
101 South Hanley Road
St. Louis, Missouri 63105
(314) 863-1100

Annual Meeting
The Annual Meeting of Shareholders will be held at 10 a.m., Monday, June 22, 1987, at the Clayton Community Center, Two Mark Twain Circle, Clayton, Missouri. Notice of the meeting and a proxy statement will be sent to shareholders in a separate mailing.

Trademarks and Trade Names
The trademarks, trade names and licensed trademarks of INTERCO and its subsidiaries, appearing in this Annual Report, are italicized.

Form 10-K Annual Report
A copy of the current Form 10-K filed with the Securities and Exchange Commission can be obtained by writing to the Treasurer of INTERCO at the Corporate Offices.

INTERCO INCORPORATED
St. Louis, Missouri